**TEACHING NOTES**

**Critical Incident Overview**

The critical incident describes the history of Facebook and its Initial Public Offering. It provides information on Mark Zuckerberg and the early years of Facebook.

This descriptive critical incident asks students in financial management, corporate finance, and/or principles of accounting to evaluate how Facebook determined the initial offering price for its stock and how it chose which stock exchange to list.

**Research Method**

The critical incident is based on personal experience and publicly available sources.

**Learning Objectives**

**Students will be able**

1. to analyze the importance of setting an appropriate price for an IPO.
2. to defend Facebook’s decision to list on NASDAQ instead of NYSE.

**Application**

This critical incident can be used as an in-class assignment or a homework assignment in an introductory finance or accounting course when discussing IPOs and stock exchanges in finance or the stockholders’ equity chapter in accounting.

**Questions**

1. How did the underwriters of the Facebook IPO determine the offering price?
2. Discuss the consequences of setting the initial price too high or too low. Since its IPO, discuss how the stock has performed.
3. Imagine you were on Mark Zuckerberg’s management team. Discuss some advantages and disadvantages you would present to him for listing on each exchange.
4. Based on what you know about Facebook and Mark Zuckerberg, discuss how you think the corporate culture at Facebook played into Mark Zuckerberg’s decision to list with the NASDAQ.

**Answers**

1. **How did the underwriters of the Facebook IPO determine the offering price?**

The underwriter should have researched the market, lined up investors and set the share price. The price of the IPO should be determined by supply and demand. Facebook needed to hire an investment bank to manage the IPO process. The investment bank, which is also known as the lead underwriter, found investors to buy into the IPO and set the share price. In determining the price the underwriter had to find a compromise between Facebook’s desire for a high price and the initial investors who wanted the price low enough to make a profit once the shares rose in value.

The process of setting the price started with the underwriter drawing up a prospectus, which contained Facebook’s current financial position and its business plan. The prospectus was distributed to potential investors, which included mutual funds, insurance companies and pension funds. These institutional investor gave “indications of interest”, which were not a binding agreement to buy shares but gave the underwriter an idea of the market demand for the stock. This in turn helped set the price.

The next step was the “road show”. Facebook’s management toured major cities for meetings with the big investors. Management put a positive spin on the information provided in the prospectus and investors could question management directly. The success of the road show was reflected in the “book”, the compilation of share orders by institutional investors.

The underwriter used information from the road show to set the "offering price” which the institutional investors paid directly to Facebook.

1. **Discuss the consequences of setting the initial price too high or too low. Since its IPO, discuss how the stock has performed.**

The initial investors paid the offering price. Once these investors had their shares they could then sell these on the stock exchange where the newly public company was listed. On the exchange the price will be determined by the demand.

If the underwriter set the initial stock price too high, the stock price would fall as soon as it started trading on the stock exchange. A drastic drop in stock price would leave a negative impression on the company’s reputation. On the other hand if the underwriter set the price too low, the company would not raise as much money as it could have. Facebook would only get money from the initial sale to the institutional investors. Any subsequent sales on the stock exchange did not go to Facebook. If the price was set too low, the stock price would jump as soon as it traded on the exchange.

Since it began trading on May 18, 2012, Facebook stock has had a rocky start. During its first year, the stock price decreased 31%, but has made a turnaround in its second year of trading increasing over 125% (as of the date of this writing 4/16/14).

1. **Imagine you were on Mark Zuckerberg’s management team. Discuss some advantages and disadvantages you would present to him for listing on each exchange.**

**NYSE**

* Advantages
  + Prestige – by listing on the NYSE, Facebook would join in the names of some of the greatest, most respected companies in history with all of the stature, celebrity and prominence that comes with it.
  + Ringing of the Bell – the NYSE has a long tradition of newly listed companies being able to ring the opening bell at the start of the trading day in an effort to expose the company name and increase demand by investors for shares.
* Disadvantages
  + Fees – new company listings require an entry fee up to $250,000 plus a $500,000 annual listing fee.

**NASDAQ**

* Advantages
  + NASDAQ MarketSite - List alongside other technology giants – listing with the NASDAQ would put the Facebook name alongside Microsoft, Intel, Apple, and Google.
  + Ringing of the Bell – the NASDAQ has a bell of their own at the NASDAQ MarketSite where companies can ring the bell to start the trading day for the NASDAQ.
* Disadvantages
  + Fees – new company listings require an entry fee up to $225,000 plus a $99,500 annual listing fee.

1. **Based on what you know about Facebook and Mark Zuckerberg, discuss how you think the corporate culture at Facebook played into Mark Zuckerberg’s decision to list with the NASDAQ?**

Facebook is a relatively new company, where the CEO dresses in jeans and a hoody. The culture is a more modern, less formal, dress down, laid back type where creativity and thinking different is rewarded, as shown with Facebook hackathons. These hackathons are 24-hour events scheduled regularly as competitions within the company where employees pitch an idea and produce a new feature for Facebook. A couple of the more popular feature created during these hackathons include the Like button and Timeline.

Mark Zuckerberg wants Facebook to be the largest technology company in the world and he wants to do it, not in a traditional, centralized way, like Ford or Coca-Cola, but in an individualistic, decentralized, open-ended style. NASDAQ, the relatively newer, technology-oriented stock exchange, is also a better fit for Facebook because it lists companies who are the pioneers of non-traditional corporate culture, like Microsoft, Intel, Apple, and Google.

**Additional pedagogical material:**

We encourage students to review the following detail example on how the price of an IPO is determined:

<http://www.forbes.com/sites/quora/2013/11/08/how-does-ipo-pricing-work/>

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